

GENERAL FUND TAXES

1. GENERAL FUND TAX CHANGES

Governor: The following table shows the general fund tax changes recommended by the Governor, along with their fiscal effects in the 2011-13 biennium. The table does not include tax law changes that are estimated to have a minimal fiscal effect, or those that would not have a fiscal impact until later years.

2011-13 General Fund Tax Changes (In Millions)

| | <u>2011-12</u> | <u>2012-13</u> | <u>2011-13 Biennium</u> |
|--|----------------|----------------|-----------------------------|
| Income and Franchise Taxes | | | |
| Capital Gains Deferral for WI Investments | -\$16.10 | -\$20.20 | -\$36.30 |
| Internal Revenue Code Update | 0.23 | -0.35 | -0.12 |
| Combined Reporting--Pre-2009 Losses | -9.20 | -37.20 | -46.40 |
| General Sales and Use Tax | | | |
| Exemption for Modular and Manufactured Homes | <u>-0.20</u> | <u>-0.26</u> | <u>-0.46</u> |
| Total Tax Changes | -\$25.27 | -\$58.01 | -\$83.28 |

There are several other changes recommended by the Governor that are not shown in the table. First, the budget bill would require that a specified percentage of state sales and use tax collections on sales and leases of motor vehicles and motor vehicle parts and accessories be deposited into the transportation fund rather than the general fund, beginning in 2012-13. In that year, the percentage to be deposited to the transportation fund would be 7.5% of such collections. Over the next nine years, the percentage would increase until it reached 50% in 2021-22. This provision would reduce general fund revenues by an estimated \$35.1 million in 2012-13, and increase transportation fund revenues by the same amount. This item is not shown in the table because it would not affect imposition of the tax. The fiscal effect would increase significantly in future years as the percentage rises.

Second, the bill would create a new individual income tax exclusion for capital gains on certain "Wisconsin-source" capital assets that are purchased after December 31, 2010, and held for at least five years. This provision is not included in the table because it would not have a fiscal effect until the 2015-17 biennium. The administration estimates that this provision would reduce income tax revenues by \$79 million annually, once fully implemented.

Finally, the table does not include proposed changes to refundable tax credits, because they are paid from appropriations rather than recorded as a reduction in tax revenues. These provisions include reestimates of the costs of existing credits, repealing indexing of the homestead tax credit, modifying the percentages used in calculating the earned income tax credit, and modifying provisions regarding eligibility for, and computation of, the refundable jobs tax credit.

Income and Franchise Taxes

1. DEFERRAL FOR CAPITAL GAIN REINVESTED IN QUALIFIED WISCONSIN BUSINESSES

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|---------|----------------|
| GPR-Tax | - \$36,300,000 |
|---------|----------------|

Governor: Authorize claimants calculating their Wisconsin adjusted gross income to subtract from federal adjusted gross income any amount of a long-term capital gain if the claimant: (a) deposits the gain into a segregated account in a financial institution; (b) invests all of the proceeds in the account in a qualified Wisconsin business within 180 days of the sale of the asset generating the gain; and (c) notifies the Department of Revenue (DOR) that the capital gain has been reinvested and, therefore, will not be declared on the claimant's income tax return. The notification would be made on a DOR form accompanying the claimant's income tax return for the year to which the claim relates. Specify that the basis for the investment in the Wisconsin business would be calculated by subtracting the initial gain from the investment. Prohibit a claimant from using the initial gain to net capital gains and losses as otherwise allowed under current law. (State law limits the amount of capital losses that may be used to offset ordinary income to \$500 annually, with the remainder carried over to future years.) Prohibit a claimant from also claiming the gain as a subtraction as a reinvestment in a qualified new business venture, under current law, or as a Wisconsin capital asset, as proposed under the bill (see Item #2, Capital Gain Exclusion for Wisconsin Capital Assets). Define "claimant" as an individual; an individual partner or member of a partnership, limited liability company (LLC), or limited liability partnership; or an individual shareholder of a tax-option corporation. Define "long-term capital gain" as the gain realized from the sale of any capital asset held more than one year that is treated as a long-term gain under the Internal Revenue Code (IRC).

Require the Wisconsin Economic Development Corporation to implement a program to certify qualified Wisconsin businesses for purposes of the capital gains deferral, and authorize the Corporation to certify businesses that apply for certification if the Corporation determines that the business meets the following criteria in the tax year immediately preceding the application: (a) the amount of payroll compensation paid by the business in Wisconsin is equal to at least 50% of the amount of all payroll compensation paid by the business; and (b) the value of real and tangible personal property owned or rented and used by the business in Wisconsin is equal to at least 50% of all such property owned or rented and used by the business. Require the Corporation to: (a) notify DOR of every Wisconsin business certified under this procedure and the date on which a certification expires or is revoked; and (b) compile a list, which is available on the Corporation's Internet Web site, of businesses certified under this procedure. Authorize the corporation, in consultation with DOR, to adopt administrative rules related to these provisions.

The proposed tax deferral would first apply for tax years beginning after December 31, 2010, and would decrease revenues by an estimated \$16,100,000 in 2011-12 and \$20,200,000 in 2012-13.

[Bill Sections: 1754, 1764, and 2863]

2. CAPITAL GAIN EXCLUSION FOR WISCONSIN CAPITAL ASSETS

Governor: Authorize claimants calculating their Wisconsin adjusted gross income to subtract from federal adjusted gross income the claimant's qualifying gain from the sale of a Wisconsin capital asset in the year to which the claim relates, but limit the subtraction to no more than the amount of the claimant's federal net capital gain as reported on the claimant's federal income tax return for the taxable year to which the claim relates. Limit the subtraction to Wisconsin capital assets purchased after December 31, 2010, and held for at least five years. Define "claimant" as an individual; an individual partner or member of a partnership, LLC, or limited liability partnership; or an individual shareholder of a tax-option corporation. Define "qualifying gain" as the gain realized from the sale of any asset: (a) which is a Wisconsin capital asset in the year that it is purchased by the claimant and is a Wisconsin asset for at least two of the subsequent four years; (b) that is held for at least five uninterrupted years; and (c) that is a long-term gain under the IRC. Specify that a qualifying gain may not include an amount for which the claimant claimed a subtraction as a reinvestment in a qualified new business venture. Define "Wisconsin capital asset" as: (a) real or tangible personal property that is located in this state and used in a Wisconsin business; or (b) stock or other ownership interest in a Wisconsin business. Define "Wisconsin business" as a business certified by the Wisconsin Economic Development Corporation. Modify the current law loss carry-forward provision to treat the proposed exclusion the same as other capital gains exclusions.

Require the Wisconsin Economic Development Corporation to implement a program to certify Wisconsin businesses for purposes of the capital gains subtraction, and authorize the Corporation to certify businesses that apply for certification if the Corporation determines that the business meets the following criteria in the tax year immediately preceding the application: (a) the amount of payroll compensation paid by the business in Wisconsin is equal to at least 50% of the amount of all payroll compensation paid by the business; and (b) the value of real and tangible personal property owned or rented and used by the business in Wisconsin is equal to at least 50% of all such property owned or rented and used by the business. Require the Corporation to: (a) notify DOR of every Wisconsin business certified under this procedure and the date on which a certification expires or is revoked; and (b) compile a list, which is available on the Corporation's Internet Web site, of businesses certified under this procedure. Authorize the corporation, in consultation with DOR, to adopt administrative rules related to these provisions.

[The Wisconsin Economic Development Corporation would use the same criteria to certify a "Wisconsin business" under these provisions and a "qualified Wisconsin business" under Item #1, "Deferral for Capital Gain Reinvested in Qualified Wisconsin Businesses." The administration indicates that it intended to allow a deferred gain reinvested in a qualified Wisconsin business to also be used for an investment that could qualify under this exclusion. If that investment is sold after a holding period of five or more years, the deferred gain would be subject to tax, but any additional gain would be excluded. A modification is needed to ensure that this intent is fulfilled.]

The proposed subtraction would first apply for taxable years beginning after December 31, 2015. Due to the provision's delayed applicability, no fiscal effect is estimated for the 2011-13

biennium. The Department of Revenue estimates that (in 2012-13 dollars) the exclusion would reduce individual income tax collections by \$6 million in the first year of the phase-in (2016-17) and by approximately \$79 million annually when fully phased in. Due to fluctuations in capital asset markets and the proposal's delayed effective date, these estimates are subject to substantial variation.

[Bill Sections: 1754, 1761, 1763, 1764, and 2862]

3. EXCLUSION FOR INTEREST ON CERTAIN WHEFA BONDS OR NOTES

Governor: Provide an exclusion from income under the individual income tax, the corporate income and franchise tax, and the income tax on insurance companies for interest income received on bonds or notes issued by the Wisconsin Health and Educational Facilities Authority (WHEFA) provided the bonds or notes are issued to a person who is eligible to receive bonds or notes from another issuer for the same purpose as the bonds or notes issued for the person by WHEFA and the interest income from those other bonds or notes would also be exempt. Extend the exclusion to tax years beginning on January 1, 2011. WHEFA provides capital financing assistance to Wisconsin health care institutions, independent colleges and universities, and certain continuing care facilities. There is a current law exclusion for interest on WHEFA-issued bonds or notes that are used by health facilities to acquire information technology hardware or software. The administration estimates that the fiscal effect of this provision would be a minimal loss of state tax revenues.

[Bill Sections: 1755, 1896, 2015, and 9341(3)]

4. EARNED INCOME TAX CREDIT

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|-------|-------------------|
| GPR | - \$101,600,000 |
| PR | <u>74,000,000</u> |
| Total | - \$27,600,000 |

Governor: Increase PR funding for the earned income tax credit (EITC) by \$37,000,000 annually and decrease GPR funding by \$50,900,000 in 2011-12 and \$50,700,000 in 2012-13 to reflect current law reestimates (\$6,400,000 GPR in 2011-12 and \$7,300,000 GPR in 2012-13), proposed changes in the percentages used to calculate the credit (-\$20,300,000 GPR in 2011-12 and -\$21,000,000 GPR in 2012-13), and the proposed increase in PR funding (-\$37,000,000 GPR annually). Modify the percentages used to calculate the EITC by increasing the percentage from 4% to 5% for claimants with one child, decreasing the percentage from 14% to 8% for claimants with two children, and decreasing the percentage from 43% to 40% for claimants with three or more children, beginning in tax year 2011.

The state credit is calculated as a percentage of the federal EITC, and is funded with a combination of GPR and PR funding. The program revenue is federal temporary assistance for needy families (TANF) funding transferred from the Department of Children and Families. The GPR portion is provided through a sum sufficient appropriation and covers the balance of the cost of the credit. Under the bill, total funding for the EITC would decrease to \$116,600,000 in 2011-12 and \$116,800,000 in 2012-13, compared to base funding of \$130,500,000. The PR funding would increase from a base level of \$6,664,200 to \$43,664,200 annually. The estimated

GPR sum sufficient portion would be decreased from the base level of \$123,835,800 to \$72,935,800 in 2011-12 and \$73,135,800 in 2012-13.

With the proposed changes in the percentages used to calculate the credit, it is estimated that the maximum state credit for families with one child would increase from \$124 to \$155 in tax year 2011. The maximum credit for families with two children would fall from \$716 to \$409, and the maximum credit for families with three or more children would fall from \$2,473 to \$2,300.

[Bill Sections: 1883 and 1884]

5. VETERANS AND SURVIVING SPOUSES PROPERTY TAX CREDIT

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| GPR | \$14,100,000 |
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Governor: Provide increases of \$6,000,000 in 2011-12 and \$8,100,000 in 2012-13 for the refundable veterans and surviving spouses property tax credit, which is paid through a sum sufficient appropriation. With these adjustments, base level funding of \$7,600,000 would increase to \$13,600,000 in 2011-12 and \$15,700,000 in 2012-13. The credit is equal to real and personal property taxes paid on a principal dwelling by certain disabled veterans and surviving spouses. The credit was first available in tax year 2005, and eligibility for the credit was expanded effective with tax year 2009. At the time base level funding was estimated, the number of claimants was under-estimated due to factors such as increasing awareness of the tax credit and the impact of the expansion in eligibility. After base level funding was estimated at \$7.6 million for 2010-11, DOA reported actual 2009-10 credit expenditures of \$9.6 million. The estimates for 2011-13 reflect continued increases in the number of credit claimants.

6. CLAIM OF RIGHT CREDIT

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|-----|-----------|
| GPR | \$344,000 |
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Governor: Provide increases of \$166,000 in 2011-12 and \$178,000 in 2012-13 for the sum sufficient appropriation for the claim of right credit. With these adjustments, base level funding of \$100,000 would increase to \$266,000 in 2011-12 and \$278,000 in 2012-13. The credit is provided to taxpayers who must repay income on which taxes were paid in a prior year. When taxpayers include a payment of \$3,000 or more in their taxable income for one year and repay that income in a subsequent year, they may claim the tax on the income as a credit on the subsequent year's tax return. The credit extends to income erroneously paid to the taxpayer and, for example, could apply to overpayments of unemployment compensation.

7. MINNESOTA-WISCONSIN RECIPROCITY

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| GPR | - \$62,450,000 |
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Governor: Decrease the estimated payments under the Minnesota-Wisconsin individual income tax reciprocity agreement by \$1,250,000 in 2011-12 and \$61,200,000 in 2012-13. On September 18, 2009, Minnesota's Governor informed Wisconsin's Governor that the Minnesota Commissioner of Revenue was exercising his authority, under Minnesota state law, to discontinue the two states' income tax reciprocity agreement as of tax year 2010. Therefore, the

agreement last applied to tax year 2009. Under the terms of the agreement, a payment was due in December of the year following the tax year for which the payment is being made. Consequently, the final reciprocity payment was due in December, 2010. However, the administration chose to defer that payment until 2011-12. That payment is estimated at \$59,950,000, which includes \$58,696,600 in principal and \$1,253,400 in interest. Depending on the payment date, the payment could vary from this estimate due to the interest component. The decrease for 2012-13 reflects that no payment will be made due to the agreement's termination, and Wisconsin will have extinguished its obligation for all prior tax years.

8. ILLINOIS-WISCONSIN INCOME TAX RECIPROCITY

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| GPR | \$33,900,000 |
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Governor: Decrease the estimated payment by \$2,400,000 in 2011-12 and increase the estimated payment by \$36,300,000 in 2012-13 under the Illinois-Wisconsin individual income tax reciprocity agreement. Payments are estimated at \$36,300,000 in 2011-12 and \$75,000,000 in 2012-13. The increase in 2012-13 is due, in part, to the increase in the Illinois individual income tax rate from 3% to 5%, effective in tax year 2011.

9. INDIVIDUAL INCOME TAX CHECKOFF FOR CAMPAIGN FUNDS

Governor: Sunset the \$3 check-off on individual income tax forms for contributions to the Election Campaign Fund and the Democracy Trust Fund, effective for tax years beginning after December 31, 2011. (Currently, the check-off does not increase an individual's tax liability or decrease an individual's tax refund.) Create a tax check-off on individual income tax forms for contributions to the Election Campaign Fund and the Democracy Trust Fund by permitting every individual who has a tax liability or is entitled to a tax refund to designate on the return \$3 for additional payment or \$3 of a refund due that taxpayer as a donation to the funds, effective with tax years beginning after December 31, 2011. Permit individuals who are filing jointly to each make a \$3 designation. Provide that the names of persons making designations to the funds be strictly confidential. The administration of the check-off would operate in the same manner as the administration of tax check-offs provided under current law. Provide for the allocation of an amount equal to the Department of Revenue's administrative expenses to the Department's existing appropriation for that purpose, and require two-thirds of the net amount designated through the tax check-off to be deposited in the Democracy Trust Fund and the balance to be deposited in the Election Campaign Fund. The proposed check-off would operate identically to the existing check-off, except that the proposed check-off would increase an individual's tax liability or decrease an individual's tax refund.

Related entries are located under Miscellaneous Appropriations and are titled "Public Financing of Campaigns for Supreme Court Justice -- Democracy Trust Fund" and "Public Financing of Campaigns for Statewide and Legislative Offices -- Wisconsin Election Campaign Fund."

[Bill Sections: 748, 752, 882 thru 885, 1885 thru 1887, and 9418(1)&(2)]

10. INTERNAL REVENUE CODE UPDATE

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| GPR-Tax - \$117,000 |
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Governor: Update statutory references to the federal Internal Revenue Code under the state individual and corporate income and franchise taxes to include changes to the IRC relating to: (a) long-term care insurance that is provided as part of an annuity or life insurance contract or as a rider on annuity or life insurance contracts, as authorized under the Pension Protection Act of 2006 (P.L. 109-280); (b) allowing participants in government-sponsored deferred compensation plans to make contributions to designated Roth accounts or to roll over amounts in their plans to designated Roth accounts, as authorized under the Small Business Jobs Act of 2010 (P.L. 111-240); (c) permitting partial annuitization of a nonqualified annuity contract, as authorized under the Small Business Jobs Act of 2010 (P.L. 111-240); and (d) qualified tax credit and Build America bonds, as authorized under the Food, Conservation, and Energy Act of 2008 (P.L. 110-246), the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), and the Hiring Incentives to Restore Employment Act of 2009 (P.L. 111-147).

Under the bill, the state's income and franchise tax statutes would continue to reference the IRC in effect as of December 31, 2008. With the exceptions noted above, none of the federal tax provisions adopted in 2009 and 2010 would be referenced in state statutes. Examples include provisions in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (P.L. 111-312), such as deductions for elementary and secondary school teacher expenses and for qualified tuition and related expenses, and the Affordable Care Act (P.L. 111-149 and 111-152), such as the exclusion for employer-provided accident or health coverage for an employee's child under the age of 27.

The proposed changes would take effect at the same time for state tax purposes as for federal tax purposes, and the administration estimates that the provision would cause state income and franchise tax revenues to increase by \$230,000 in 2011-12 and decrease by \$347,000 in 2012-13. These amounts are comprised of: (a) -\$710,000 in 2011-12 and -\$1,200,000 in 2012-13, relating to long-term care insurance; (b) \$822,000 in 2011-12 and \$660,000 in 2012-13, relating to contributions and rollovers to Roth accounts; and (c) \$118,000 in 2011-12 and \$193,000 in 2012-13, relating to partial annuitizations. The administration indicates that codifying IRC references to qualified tax credit and Build America bonds is intended to clarify Wisconsin's tax treatment and would not result in a revenue change.

Qualified tax credit bonds are issued by state and local governments and include qualified forestry conservation bonds, clean renewable energy bonds, energy conservation bonds, zone academy bonds, and school construction bonds. Generally, the bonds do not bear interest but, instead, generate a tax credit for bondholders based on the interest that would otherwise be expected to accrue. The credit is included in the bondholder's gross income and is subject to tax. Also, the credit may be claimed against the taxpayer's income tax liability, and unused credits may be carried forward to future years. The American Recovery and Reinvestment Act of 2009 authorized state and local governments to issue Build America bonds, but that authorization expired on January 1, 2011. Interest on Build America bonds is taxable, but the federal government lowers the interest cost by providing a subsidy equal to 35% of the interest cost either as a payment to the issuer or as a tax credit to the bondholder. Most interest on state and local bonds is subject to taxation at the state level, even though it is exempt from federal

taxation. Including the indicated provisions would ensure that the tax credits from qualified tax credit bonds and from Build America bonds would be treated like state and municipal bond interest and therefore subject to Wisconsin tax.

[Bill Sections: 1753, 1890, 1891, 1897, 2013, and 2014]

11. ANGEL AND EARLY STAGE SEED INVESTMENT TAX CREDITS

Governor: Clarify that shareholders of tax-option corporations (S corporations) could claim the angel investment tax credit based on eligible investments made by the tax-option corporation. The tax-option corporation could not claim the credit, but the amount of the credit would be based on the corporation's eligible investments. The tax-option corporation would be required to compute the amount of credit each shareholder could claim and provide that information to them. Shareholders of tax-option corporations could claim the credit in proportion to their ownership interest, or as specifically allocated in their organizational documents. This provision would correct a drafting error to provide tax-option corporations with the same treatment provided to partnerships and LLCs under the angel investment tax credit. Generally, partnerships, LLCs, and tax-option corporations are provided this treatment for all tax credits claimed under the state individual income and corporate income and franchise taxes.

The bill would also specify that, for investments made after December 31, 2007, for angel and early stage seed investment tax credits, the claimant would be required to hold the investment for three years, or if the investment were held for less than three years, to repay the credit in a manner prescribed by the Department of Revenue. The provision requiring that angel and early stage seed investments be held for three years after December 31, 2007, was enacted in 2007 Act 20, (the 2007-09 biennial budget act). Prior to Act 20, the holding period was 12 months. This provision clarifies that the three-year holding period applies only to investments made after December 31, 2007. The 12-month holding period would apply to investments made before that date.

The early stage business investment program includes the angel investment tax credit, which can be claimed under the state individual income tax, and the early stage seed investment tax credit, which can be claimed under the state individual income, corporate income/franchise taxes, and insurance premiums taxes.

Angel Investment Tax Credit. The angel investment tax credit equals 25% of the claimant's bona fide angel investment made directly in a qualified new business venture (QNBV) for the tax year. The maximum aggregate amount of angel investment tax credits that can be claimed for a tax year is \$20 million, plus an additional \$250,000 for tax credits claimed for investments in nanotechnology businesses. The maximum total amount of tax credits that can be claimed for all tax years is \$47.5 million.

Early Stage Seed Investment Tax Credit. The early stage seed investment tax credit is equal to 25% of the claimant's investment paid in the tax year to a certified fund manager that the fund manager invests in a QNBV certified by the Department of Commerce (Commerce). The maximum aggregate amount of early stage seed investment tax credits that can be claimed for a

tax year is \$20.5 million, plus an additional \$250,000 for tax credits claimed for investments in nanotechnology businesses.

The aggregate amount of investment in any one QNBV that may qualify for early stage seed investment and angel investment tax credits is \$8.0 million. Investments in a QNBV must be maintained in the business for at least three years. As noted, the statutes specify that partners and members of LLCs may claim angel investment tax credits in proportion to their ownership interest, or as specially allocated in organizational documents. Partners, members of LLCs, and shareholders of tax-option corporations may claim early stage seed investment tax credits in proportion to their ownership interest, or as specially allocated in organizational documents. [Under the bill, Commerce's responsibilities regarding these credits and other tax credits would be transferred to the Wisconsin Economic Development Corporation.]

[Bill Sections: 1864, 1869, 1872, 1873, 2003, and 2114]

12. DAIRY MANUFACTURING FACILITY INVESTMENT TAX CREDIT MODIFICATIONS

Governor: Specify that the provision that limits, to \$200,000 for each manufacturing facility, the aggregate amount of dairy manufacturing facility investment tax credits a partnership, LLC, tax-option corporation, and dairy cooperative could claim would only apply to dairy cooperatives. All other entities would be subject to an aggregate total tax credit limit of \$200,000. The modifications to the aggregate credit claim limit would first apply to tax years beginning after December 31, 2010. In addition, the bill would convert the appropriation from which refundable dairy manufacturing facility tax credits are paid to individuals, corporations, and pass-through entities from annual to continuing.

The refundable dairy manufacturing facility investment tax credit is equal to 10% of the amount paid in a tax year by a claimant for modernization or expansion related to the claimant's dairy manufacturing operation. The credit can also be claimed for eligible investments made by dairy cooperatives. The credit is refundable. If the allowable credit claim exceeds the tax due, the amount not used to offset the tax is paid to the claimant. Refunds to individuals, corporations, and pass-through entities are paid from an annual GPR appropriation. Refunds to cooperatives are paid from a sum-sufficient GPR appropriation.

Partnerships, LLCs, tax-option corporations, and dairy cooperatives may not claim the tax credit, but the eligibility for, and the amount of credit is based the payment of eligible expenses by the entity. A partnership, LLC, tax-option corporation, and cooperative is required to compute the amount of credit that each of its partners, members, or shareholders may claim and report that information to each of them. Partners, members of LLCs, and shareholders of tax-option corporations may claim the credit in proportion to their ownership interest. Members of a dairy cooperative may claim the credit in proportion to the amount of milk that each member delivers to the dairy cooperative, as determined by the cooperative.

The total amount of tax credits that can be claimed is limited to \$700,000 annually for cooperative members, and \$700,000 annually for other entities. The maximum aggregate amount

of tax credits that a claimant can claim is \$200,000 for C corporations and individuals and \$200,000 per facility for pass-through entities and cooperatives. A credit cannot be claimed for expenses that were deducted as trade or business expenses.

[Bill Sections: 772, 1826, 1963, 2075, and 9341(1)]

13. COMBINED REPORTING -- USE NET BUSINESS LOSS CARRY-FORWARDS INCURRED BEFORE 2009

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|---------|----------------|
| GPR-Tax | - \$46,400,000 |
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Governor: Authorize combined groups to share net business loss carry-forwards that were incurred by group members before January 1, 2009. Starting with the first tax year beginning after December 31, 2011, and for each of the 20 subsequent tax years, for each tax year that a corporation was a member of a combined group and had a net business loss carry-forward from a tax year beginning prior to January 1, 2009, the corporation could use up to 5% of its remaining business loss carry-forward to proportionally offset the income of all other members of the combined group, to the extent that income was attributable to the unitary business. Before sharing the business loss carry-forward with group members, the corporation would first have to use the loss carry-forward to offset its own income for the tax year. If the full 5% of such business loss carry-forwards could not be completely used to offset the income of other members of the combined group, the remainder could be added to the portion of the corporation's loss carry-forward that could be used to offset the income of group members in the subsequent year. Unless otherwise provided by DOR by rule, the corporation could not share the loss carry-forward if it ceased being included in the combined group. DOR would be required to promulgate administrative rules to administer these provisions. These provisions would reduce corporate income and franchise tax revenues by an estimated \$9,200,000 in 2011-12, and \$37,200,000 in 2012-13.

Although similar to federal law, Wisconsin has specific state provisions governing the determination and use of net business losses for state corporate income/franchise tax purposes. Under state law, a net business loss is generally defined as the excess of business expenses allowed as deductions in computing net income over the amount of income attributable to the operation of a trade or business in the state. Wisconsin law allows net business losses to be carried forward for 15 years to offset income. Federal law permits net business losses to be carried back for two years, but state law does not provide for carry-backs of net business losses. Certain unused business loss carry-forwards generated by members of a combined group can be shared with other members of the group to offset their net income.

Individual combined group members that show a positive income amount can offset the income with net business loss carry-forwards. A net business loss carry-forward is an attribute of the separate corporation that generated the loss. However, the combined group member may share all or a portion of its business loss carry-forward with other members of the combined group, if certain conditions are met. Specifically, the amount of net business loss carry-forward that is eligible for sharing with other combined group members is computed and assigned as follows:

a. Each combined group member applies its total available net business loss carry-forward against its total Wisconsin income, including net income or loss attributable to separate

entity items (income or loss subject to water's edge rules, income or loss attributable to a separate unitary business, nonapportionable income, lottery prizes). The member's carry-forward is first used to offset net income from separate entity items, and then its share of combined unitary income.

b. Each member then separates any remaining business loss carry-forward into the sharable and nonsharable amounts. Each member's remaining sharable net business loss is aggregated for the combined group as a whole. (A member may elect to exclude some or all of its sharable net business loss from the aggregate sharable net business loss computed for the combined group.)

c. When a combined group member has unitary income that is not offset by that member's net business loss carry-forwards, the group's aggregate sharable net business loss is assigned to the member in proportion to its share of the combined unitary income of the group. An amount of the group's sharable business loss carry-forwards cannot be assigned to a combined group member whose share of combined unitary income, net of any losses already applied by that member, is zero or less.

d. The aggregate sharable business loss of the combined group is considered to be used proportionally to the individual sharable net business loss carry-forwards of the corporations that contributed to the aggregate sharable amount. Any remaining sharable net business loss carry-forward is an attribute of the corporation that originally incurred the loss. Consequently, the amount of the unused aggregate sharable business loss carry-forwards retained by a combined group member is proportionate to the amount contributed by the member.

A net business loss carry-forward is sharable if the following conditions are met:

a. The net business loss originated in tax years beginning on or after January 1, 2009, and is attributable to combined unitary income included in a combined report.

b. The member originally computed the net business loss in the combined report used for the same combined group that will use the shared loss carry-forward, regardless of whether corporations have joined or left the combined group in the intervening years.

c. The member is still a member of the combined group for the year for which the loss carry-forward will be used.

[Bill Sections: 1893 and 1894]

14. COMBINED REPORTING -- DEPARTMENT OF REVENUE AUTHORITY TO DISALLOW COMMONLY CONTROLLED GROUPS

Governor: Delete the current requirement that DOR must disregard the tax effect of an election to include a commonly controlled business in a combined group, or disallow the election, for any year of the election period if the Department determines that the election has the effect of tax avoidance. Instead, prohibit DOR from disregarding the tax effect of an election to

include a controlled business in a combined group, or from disallowing the election. This provision would apply retroactively to tax years beginning on or after January 1, 2009.

Wisconsin's combined reporting law requires a corporation to use combined reporting if it satisfies all of the following conditions:

- a. The corporation is a member of a "commonly controlled group."
- b. The corporation is engaged in a "unitary business" with one or more other corporations in its commonly controlled group, or the commonly controlled group makes a controlled group election. The designated agent of a combined group can elect, without first obtaining approval from DOR, to include in its combined group every corporation in a commonly controlled group, regardless of whether such corporations are engaged in the same unitary business.
- c. The corporation is not excluded from the combined group under "water's edge" rules.

A "commonly controlled group" can be any one or combination of four types of arrangements, based on ownership of stock that represents more than 50% of voting power. Specifically, there must be common ownership of stock representing more than 50% of the voting power of the corporations, in any commonly controlled group. A corporation owns stock representing more than 50% of voting power if it owns or controls more than 50% of all classes of stock entitled to vote.

[Bill Sections: 1892, 9341(4), and 9441(2)]

15. JOBS TAX CREDIT MODIFICATIONS

Governor: Make the following modifications to provisions of the refundable jobs tax credit, under the state individual income and corporate income and franchise taxes: (a) delete the requirements that the credit be based on eligible employee wages between \$20,000 and \$100,000 in a tier I county or municipality, and wages between \$30,000 and \$100,000 in a tier II county or municipality; (b) provide that, for a claimant that increases net employment, the jobs credit would equal the lesser of 10% of wages paid to an eligible employee or \$10,000; and (c) convert the appropriation from which jobs tax credit refunds are paid from an annual GPR appropriation to a continuing GPR appropriation.

The jobs tax credit was enacted in 2009 Act 28, and equals up to 10% of the wages paid to an eligible employee and/or the amount of costs incurred to undertake training activities in a tax year. Specifically, a person that is certified by the Department of Commerce can claim the jobs tax credit if, in each year for which the tax credit is claimed, the person increases net employment in the person's business and one of the following applies:

- a. In a tier I county or municipality, an eligible employee, for whom the tax credit is claimed, will earn at least \$20,000 but not more than \$100,000 in wages, in the year for which the credit was claimed.

b. In a tier II county or municipality, an eligible employee, for whom the tax credit is claimed, will earn at least \$30,000 but not more than \$100,000 in wages, in the year for which the credit was claimed.

c. In a tier I or tier II county or municipality, the person improves the job-related skills of any eligible employee, trains any eligible employee on the use of job-related new technologies, or provides job-related training to any eligible employee whose employment represents the employee's first full-time job.

As noted, the jobs tax credit is refundable. If the amount of credit exceeds a claimant's tax liability, the state will issue a check to the claimant for the unused tax credit amount. The refunds are paid from an annual GPR appropriation

The maximum amount of tax credits that Commerce can allocate in a calendar year is \$5 million. In addition, the total amount of credits that can be claimed for tax years beginning on or after January 1, 2010, and ending on June 30, 2013, is limited to \$14.5 million. Tax credits certified by Commerce for tax years beginning after December 31, 2009 and before January 1, 2012, must be paid in tax years beginning after December 31, 2011. Commerce is also authorized to reallocate angel investment and early stage seed investment tax credits that are unused in any calendar year to persons eligible for the jobs tax credit, subject to 14-day passive review by the Joint Committee on Finance. These reallocated amounts are not subject to the \$5 million limit on annual jobs tax credit claims.

[Bill Sections: 771, 2864, 3357 thru 3360, and 9441(1)]

16. JOBS TAX CREDIT SUM SUFFICIENT ESTIMATE

| | |
|-----|-------------|
| GPR | \$9,000,000 |
|-----|-------------|

Governor: Provide \$9,000,000 in 2012-13 to establish the funding level for the refundable jobs tax credit, as described in the preceding entry.

17. ENTERPRISE ZONES TAX CREDIT SUM SUFFICIENT REESTIMATE

| | |
|-----|--------------|
| GPR | \$37,500,000 |
|-----|--------------|

Governor: Provide increases of \$8,600,000 in 2011-12 and \$28,900,000 in 2012-13 for the sum sufficient appropriation for the enterprise zones jobs tax credit to reestimate tax credit claims during the biennium. The reestimates reflect projections of substantial tax credit claims from major economic development projects under the program. With these adjustments, total funding would be increased from \$5,200,000 to \$13,800,000 in 2011-12 and \$34,100,000 in 2012-13.

18. BEGINNING FARMER AND FARM ASSET OWNER TAX CREDITS SUM SUFFICIENT ESTIMATE

| | |
|-----|-------------|
| GPR | \$2,060,500 |
|-----|-------------|

Governor: Provide \$860,500 in 2011-12 and \$1,200,000 in 2012-13 to establish the funding level for the sum sufficient appropriation for the beginning farmer and farm asset owner

tax credit. 2009 Act 28 created a refundable beginning farmer tax credit and a refundable farm asset owner tax credit, under the state individual income and corporate income and franchise taxes, for tax years beginning after December 31, 2010. The beginning farmer tax credit equals the amount paid by the beginning farmer to enroll in a financial management program in the year to which the claim relates. The credit can be claimed on a one-time basis, and the maximum credit is \$500. The farm asset owner tax credit equals 15% of the amount received by an established farmer for leasing agricultural assets to a beginning farmer in the year to which the claim relates.

19. FOOD PROCESSING PLANT AND FOOD WAREHOUSE INVESTMENT TAX CREDIT SUM SUFFICIENT REESTIMATE

| | |
|-----|---------------|
| GPR | - \$1,000,000 |
|-----|---------------|

Governor: Decrease funding by \$500,000 annually for the refundable food processing plant and food warehouse investment tax credit to establish an annual appropriation of \$700,000 for the tax credit. The credit is provided, under the state individual income and corporate income and franchise taxes, equal to 10% of the amount paid in the tax year by the claimant for food processing or food warehousing modernization or expansion. The credit can be claimed for tax years beginning after December 31, 2009, and before January 1, 2017. The total amount of tax credits that could be claimed was \$1,200,000 for fiscal year 2010-11. However, the maximum total tax credit limit is \$700,000 for subsequent fiscal years.

20. FILM PRODUCTION SERVICES TAX CREDIT SUM SUFFICIENT REESTIMATE

| | |
|-----|-------------|
| GPR | - \$200,000 |
|-----|-------------|

Governor: Decrease funding by \$100,000 annually for the refundable film production services tax credit to establish an annual appropriation of \$400,000. The credit is provided under the state individual income and corporate income and franchise taxes and can be claimed for: (a) an amount equal to 25% of salaries, wages, and/or labor-related contract payments to all individuals, including actors, who are Wisconsin residents that work on an accredited production in Wisconsin; and (b) an amount equal to 25% of non-labor production expenses incurred in Wisconsin to produce an accredited production. The maximum amount of film production tax credits that can be claimed in a fiscal year is \$500,000.

21. FILM PRODUCTION COMPANY INVESTMENT TAX CREDIT SUM SUFFICIENT ESTIMATE

| | |
|-----|-----------|
| GPR | \$200,000 |
|-----|-----------|

Governor: Provide \$100,000 annually to establish the funding level for the film production company investment tax credit. 2009 Act 28 converted the film production company investment tax credit to a refundable tax credit. The credit can be claimed under the state individual income and corporate income and franchise taxes, and equals 15% of the following that the claimant paid in the tax year to establish or operate a film production company in Wisconsin: (a) the purchase price of depreciable, tangible personal property and items, property, and goods, if the sale of such property and goods is sourced to Wisconsin; and (b) the amount expended to construct, rehabilitate, remodel, or repair real property. The maximum amount of

film production tax credits that can be claimed in a fiscal year is \$500,000.

Sales and Excise Taxes

1. DEPOSIT SALES AND USE TAX REVENUE GENERATED FROM SALES OF MOTOR VEHICLES AND MOTOR VEHICLE PARTS AND ACCESSORIES INTO THE TRANSPORTATION FUND

| | |
|---------|----------------|
| GPR-Tax | - \$35,127,000 |
|---------|----------------|

Governor: Provide that a specified percentage of sales and use tax revenues generated from the sale, lease, or use of motor vehicles and motor vehicle parts and accessories would be deposited into the transportation fund, instead of the general fund. Require DOR to annually estimate the amount of revenue generated from such sales to be deposited into the transportation fund beginning with tax revenues received on July 1, 2012. Specify that the percentage of sales tax revenues generated from the sale, lease, or use of motor vehicles and motor vehicle parts and accessories that are deposited into the transportation fund would increase over a ten-year period in the following manner:

- a. 7.5% of revenues for 2012-13, but not more than \$35,127,000;
- b. 10% of revenues for 2013-14;
- c. 15% of revenues for 2014-15;
- d. 20% of revenues for 2015-16;
- e. 25% of revenues for 2016-17;
- f. 30% of revenues for 2017-18;
- g. 35% of revenues for 2018-19;
- h. 40% of revenues for 2019-20;
- i. 45% of revenues for 2020-21;
- j. 50% of revenues for 2021-22 and each year thereafter.

The administration estimates that \$35,127,000 of sales tax revenues would be deposited into the transportation fund in 2012-13 under the proposal. The amount deposited into the transportation fund (in 2012-13 dollars) would increase to an estimated \$58 million in 2013-14, \$88 million in 2014-15, and would ultimately increase to approximately \$292 million in 2021-22. [The segregated transportation fund revenue increase under this provision is shown under "Transportation -- Transportation Finance."]

[Bill Sections: 881 and 2182]

2. SALES AND USE TAX EXEMPTION FOR MODULAR AND MANUFACTURED HOMES

| | |
|---------|-------------|
| GPR-Tax | - \$455,000 |
|---------|-------------|

Governor: Create an exemption from the sales and use tax for modular homes and

manufactured homes that are used in real property construction activities outside this state. The proposal would become effective on the first day of the third month beginning after publication of the budget bill. Assuming an effective date of October 1, 2011, the administration estimates that the proposal would reduce sales and use tax revenue by \$195,000 in 2011-12 and \$260,000 in 2012-13.

Under current law, sales of modular homes and manufactured homes are subject to the state sales and use tax. For new manufactured homes, 35% of the sales price is exempt from tax. For certain modular homes, either 35% of the sales price or the sales price minus the cost of materials that became component parts of a building being sold are exempt from the tax. According to DOR, the intent of the Governor's proposal is to create a new sales and use tax exemption for modular homes and manufactured homes if the home is destined to become real property in another state.

Under current law, if a Wisconsin manufacturer sells a modular home or a manufactured home to a dealer located in Wisconsin, the dealer must determine whether the home will become a real property construction or if the home will be sold as tangible personal property. If the home will be sold as tangible personal property, the tax is collected on the sales price of the transaction from the dealer to the ultimate consumer for sales in Wisconsin. For sales in other states, their state law would apply. If the home will be sold for use in real property construction, the sales tax is collected on the sales price of the transaction from the manufacturer to the dealer as the final taxable sale. The subsequent sale from the dealer to the consumer is a sale of real property and is not a taxable sale.

According to DOR, variability in the treatment of modular home and manufactured home sales among states can result in multiple states imposing sales tax on the same product. If a Wisconsin manufacturer sells a manufactured or modular home destined to become a real property construction to a dealer located in Wisconsin, the tax is imposed on the transaction between the manufacturer and the dealer. For example, if the Wisconsin dealer sells the home to a consumer in Iowa, Iowa imposes sales tax on the purchase price of the transaction between the dealer and the final consumer, but generally allows credit for the tax paid to Wisconsin. Because of the complexity, manufacturers and dealers often remit the tax incorrectly, resulting in Wisconsin tax due upon audit. At that time, years may be closed to claims of credit in other states. This puts Wisconsin dealers at a competitive disadvantage compared to a similar dealer located in Iowa. The proposal would eliminate liability for Wisconsin sales tax for sales of modular and manufactured homes destined to become real property in other states. The other state would impose its sales or use tax as applicable.

[Bill Sections: 2179 and 9441(3)]

3. SALES TAX EXEMPTION FOR CERTAIN OIL AND FAT CONVERTED INTO FUEL

Governor: Create an exemption from the sales and use tax for sales of vegetable oil or animal fat that is converted into motor fuel that is exempt from the state motor vehicle fuel tax under the exemption for personal renewable fuel. Under the personal renewable fuel exemption,

the motor fuel tax is not imposed on the first 1,000 gallons of renewable fuel produced or converted from another purpose each year by an individual and used by the individual in his or her personal motor vehicle, provided that the individual does not sell any such renewable fuel during that year. The proposed sales tax exemption would become effective on the first day of the third month beginning after publication of the budget bill, and is expected to have a minimal fiscal effect.

[Bill Sections: 2181 and 9441(4)]

4. CIGARETTE AND TOBACCO PRODUCTS TAX REFUNDS

| | |
|-----|--------------|
| GPR | \$11,500,000 |
|-----|--------------|

Governor: Increase funding for cigarette and tobacco products tax refunds by \$4,500,000 in 2011-12 and \$7,000,000 in 2012-13 to reflect higher estimates of the sum sufficient appropriation amounts required to reimburse Native American tribes under present law. With these adjustments, estimated total funding in the cigarette and tobacco products tax refunds appropriation would increase to \$47,500,000 in 2011-12 and \$50,000,000 in 2012-13. Under current law, for sales that occur on reservations or trust lands, the tribes receive a refund of 100% of the excise tax on cigarettes sold to Native Americans and 70% of the tax on sales to non-Native Americans. For tobacco products sold on reservations or trust lands, the tribes receive a refund of 100% of the tax on products sold to tribal members and 50% of the tax on products sold to non-Native Americans.

2009 Act 28 enacted higher tax rates for cigarettes (\$2.52 per pack from \$1.77 per pack) and tobacco products (100% of the manufacturer's list price for moist snuff and 71% of the manufacturer's list price for other tobacco products, but not more than 50¢ per cigar, from \$1.31 per ounce of moist snuff and 50% of the manufacturer's list price for other tobacco products, but nor more than 50¢ per cigar). The higher taxes took effect on September 1, 2009. In order to account for the impact of the tax increases, funding for tribal refunds was increased from the 2007-08 base level of \$30,700,000 to \$39,500,000 in 2009-10 and \$42,000,000 in 2010-11. Actual expenditures totaled \$42,489,900 in 2009-10, and 2010-11 refund amounts have been reestimated by this office at \$45,200,000. The increase in the sum sufficient estimate for the 2011-13 biennium reflects the higher-than-anticipated expenditures that have occurred since the tax increases took effect, and the Department of Revenue's expectation that purchases of cigarettes and tobacco products from tribal reservations will become an increased share of total cigarette and tobacco product purchases over the biennium.